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TAGS: ENRG ECON ETRD EAID SENV PE
SUBJECT: CAMISEA SCORECARD: TOLEDO'S GREAT LEGACY

¶1. (U) SUMMARY: The Camisea natural gas project has been a qualified success. Peru is increasingly using Camisea gas (cleaner, cheaper than diesel) in power generation, industry, homes and vehicles, with Peruvians benefiting from lower electricity rates -- even before construction of the project began. Camisea has thus freed Peru from the energy crises several countries in the region still face. Natural gas is a top priority for the Garcia administration as a vehicle for poverty alleviation. Ongoing "renegotiation" talks are mainly to solidify existing pricing practices. We expect that the Garcia administration will carry out a careful oversight of the existing Camisea operations, foster the development of the domestic gas market and support a best practices completion of the Peru LNG export project.

¶2. (U) Liquids pipeline breaks in the unstable jungle terrain have caused short interruptions in flow and apparently minor environmental effects. The IDB and GOP are commissioning independent audits to determine the causes of the pipeline breaks and their environmental effects. IDB-imposed conditions have helped to meet the environmental and social challenges of the project, and there have been lessons learned. Decades of pollution by fishmeal plants of Paracas Bay, site of the fractionation plant and shipping facilities, have begun to be reversed. Local concerns about ship traffic are reduced but present; most local concerns about Camisea center on getting funding for municipal projects. The Peru LNG project appears well situated to learn from Camisea. Conflict of interest allegations have not been substantiated. The real public issues remaining are environmental related to the liquids pipeline ruptures, social, and government regulatory and oversight capacity -- challenges present but surmountable.

¶3. (U) This cable will focus on the natural gas and electricity uses derived from the Camisea project. Septels will report updates on the liquids pipeline ruptures; Paracas Bay; side effects in the gas fields; an analysis of Camisea critics; and the Peru LNG project. END SUMMARY.

GAS FOR THE MASSES, CHEAPER ELECTRICITY

¶4. (U) The Camisea natural gas project has been a success, qualified by continuing concerns over environmental and social side effects. Two years after the Camisea pipelines began to flow in August 2004,

the project has delivered natural gas and liquids products to Peru's domestic market, and some liquid derivatives (naphtha, propane, butane and diesel) to export markets. The main benefit Camisea has afforded lower income Peruvians is through cheaper than diesel power generation, yielding lower electricity rates for households and industries. The availability of natural gas and condensates products, in quantities above the local average consumption and at prices below the world market, has saved Peru from undergoing the energy crisis that has hit several other South American countries.

¶5. (U) Electricity rates for consumers were lower as early as 1996 due to the planned Shell Camisea project. The GOP sets rates for regulated electricity users (less than 1 MW) based on the expected supply-demand situation and marginal costs. The GOP lowered rates from 1996-1998 based on the projected opening of a converted gas-fired power plant. After Shell dropped out, the GOP again lowered rates from 2000 on as Hunt/PlusPetrol took over the Camisea project.

¶6. (U) An official of PlusPetrol -- the Camisea field extractor as well as distributor -- estimated savings of $1.15 billion by Peruvian electricity consumers from December 2000 to mid-2006. The rationale is that power generators would have had to use diesel, at ever-soaring world prices, while the Camisea consortium has sold natural gas to power generators at $1.30 per million British thermal units (Btu) since August 2005. Two electricity generating plants (totaling a capacity of about 500 MW) have converted to natural gas, with another 174 MW plant due to start up in November 2006, and whose capacity will be doubled in 2007. These plants are vital considering that Peru's annual power consumption is 3,200 MW; Peru's installed power generating capacity is slightly less than 3,000 thermal MW and slightly over 3,000 hydroelectric MW.

DIRECT GAS USE INCREASING

¶7. (U) The initial $100 million GOP financial assistance program to stimulate conversion to natural gas of homes, vehicles and industries has spurred such conversions in private vehicles (at the current rate of 100 cars per week), especially the Lima commuter transportation system that is wholly private. Peru inaugurated last year the world's first natural gas-powered freight train, used to transport minerals and metals from the central highlands to the port of Callao.

¶8. (U) From the $100 million fund, administered by state-owned development bank COFIDE, the average taxi owner receives a $900 loan without downpayment. S/he leaves the fuel conversion plant with a "smart charge" chip installed in the taxi, which gradually pays back the loan each time s/he fills the tank. The savings on fuel consumption are so great -- 50 to 60 percent -- that the average taxi owner pays back the conversion cost in two to four months of operation. In the first half of 2006, gas distributor Calidda had converted 1,600 vehicles, compared with 1,200 in all of 2005 and 900 in 2004.

¶9. (U) One limitation had been too few conversion facilities. Until six months ago, many taxi drivers complained to Econoff of a 3-month wait for conversion. Now, there are 22 conversion facilities and same-day service. Another factor that inhibits conversions is the number of retail fuel stations - only two in a city of over 8 million. Four more stations will operate by September, with another four in the planning stage, to open by December. Nevertheless, at least one commercial long-distance bus company has converted its vehicles.

¶10. (U) At the end of June 2006, Peru also had 116 industrial consumers using Camisea natural gas (producing ceramic tiles, paint, food, cement, steel products, tin metal, etc.), compared with two power plants and 67 industries at the end of 2005 and one power plant and six industries at the end of 2004. Still, there are many factories that use liquefied petroleum gas (LPG). Residential and industrial use of LPG has boomed since last year as Camisea sells (from the fractionation plant) blends of propane and butane to local distributors of LPG at a 20 percent to 25 percent discount compared to export prices.

¶11. (U) Home natural gas connections in Lima (housing 1/3 of Peru's population) have proceeded at a steady pace, with about 3,300

residential clients at the end of June 2006, compared with 1,400 at the end of 2005 and none at the end of 2004. Many Lima households have used LPG in their homes for many years for cooking and water heating, using large or small cylinders. A methodical laying of pipelines in Lima's more affluent neighborhoods has been underway for over a year. Subscriptions from homeowners would have been higher in the absence of some Municipalities' obstructionist regulations, some of which charged high permitting fees or stopped pipeline-laying work even after granting permits.

¶12. (U) In conversations with Calidda and with homeowners in Econoff's neighborhood where gas lines were recently installed, it appeared that high upfront connection costs (around $1,100 per single family home and $900 to $1,100 per apartment, excluding the purchase of new appliances or water heaters) were one negative factor. A distributor of the meters that are sold with the gas contracts complained to Econoff that Calidda is neglecting to give potential customers information that explains their cost savings over time. Another factor were the weeks of media coverage of explosions in the liquids pipeline over the past year, leading the consumers interviewed to express fear that a home explosion was a danger.

GAS DEMAND

¶13. (U) The domestic market remains relatively small for a project the size of Camisea, as foreseen from its inception, and has not grown at the pace the parties involved had wanted. Although the liquids pipeline is meeting demand for the four liquids products, gas is reinjected into the Camisea fields due to lack of demand. Gas may continue to be reinjected at the Camisea fields for seven or eight more years according to current estimates of field operator PlusPetrol. The Peru LNG export project will offer an outlet for Camisea natural gas production that exceeds domestic demands, providing additional revenue as well as eliminating the waste of gas attendant upon reinjection.

U.S. OPPORTUNITIES AND SUCCESS STORIES

¶14. (U) The International Gas Fair is going on in Lima now, and many U.S. and other service providers and manufacturers are represented. The Embassy welcomes a trade mission facilitated by the Department of Commerce that will survey gas opportunities in October. In addition to the many U.S. firms that have supplied or will supply inputs to the Camisea and Peru LNG projects, other firms are already making use of Camisea gas. Caterpillar earth moving machines use natural gas power. The Yanacocha mine (majority owned by U.S. firm Newmont) is powered by Caterpillar generators that run on Camisea gas. Almost all of the naphtha produced at the fractionation plant, and some of the LPG, are shipped to the U.S.

COMMENT

¶15. (U) Peru's poor, middle-class, large industries and entrepreneurs have gotten cheaper, cleaner energy from the Camisea project. As Septels will report, there have been some limited environmental and social costs in remote areas. These costs will probably pale beside the air quality improvements from natural gas vehicle power that will eventually inure to the benefit of the one third of Peru's population that lives in Lima. For a country desperately in need of job creation, poverty alleviation, affordable energy and improved health, there has been no benefit as great as the environmentally friendly energy self-sufficiency that Camisea will bring.
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